Supreme Court, U.S.
FILED
JUL 18 1988
JOSEPH F. SPANIOL, JR.
CLERK

(5)

No. 87-1897

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

FREDRIC HABERMAN, *et al.*,

Appellants,

vs.

WASHINGTON PUBLIC POWER SUPPLY SYSTEM, *et al.*,

Appellees.

ON APPEAL FROM THE SUPREME COURT OF WASHINGTON

MOTION TO DISMISS OR AFFIRM

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QUESTIONS PRESENTED

(1) Does 28 U.S.C. § 1257(2) confer jurisdiction upon this Court to hear an appeal from an order of a state's highest court upholding a statute of that state against a federal constitutional challenge:

(a) where the order of the state's highest court remands the case for further proceedings, and thus is not on its face a final judgment or order of that court; and

(b) where the order of the state's highest court cannot possibly fit any of the exceptions to the final order rule under the doctrine of *Cox Broadcasting Corp. v. Cohn*, 420 U.S. 469 (1975)?

(2) Does a ruling by the highest court of a state upholding a statute of that state against constitutional challenge under the "Contracts Clause" present a substantial federal question, where:

(a) the statute merely fixes part of the proof required for recovery under a statutory remedy of that state;

(b) the contract allegedly impaired makes no reference to the statutory remedy, and only refers to statutory state law in the broadest, most generic way; and

(c) the statute in issue does not alter the contractual obligations of any party in this litigation?

PARTIES BELOW

The list of parties to this appeal may be found in an attachment to the Jurisdictional Statement of the Appellants entitled "Schedule of All Parties to Proceedings Below" which is incorporated herein by reference.

STATEMENT PURSUANT TO RULE 28.1

The Statement Pursuant to Rule 28.1 may be found in an attachment to this brief.

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ON APPEAL FROM THE SUPREME COURT OF WASHINGTON

MOTION TO DISMISS OR AFFIRM

Appellees[1] move this Court to dismiss the appeal herein or, in the alternative, to affirm the decision and order of the Supreme Court of Washington on the grounds that the purported federal question raised on appeal is so insubstantial as to require no further argument.

[1] Appellee-defendants joining this motion are listed at the end of this brief, along with their counsel. All Appellees joining this motion are also joining in a companion motion to dismiss another appeal from the same order and decision filed by certain Intervenor-plaintiffs, American Express Travel Related Services Company, Inc., *et al.* v. The Washington Public Power Supply System, *et al.*, No. 87-1889.

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

Appellants assert jurisdiction for this appeal under 28 U.S.C. § 1257(2), which provides:

> Final judgments or decrees rendered by the highest court of a State in which a decision could be had, may be reviewed by the Supreme Court as follows:
>
> * * *
>
> (2) By appeal, where is drawn in question the validity of a statute of any state on the ground of its being repugnant to the Constitution, treaties or laws of the United States, and the decision is in favor of its validity.

Appellants challenge the validity of Wash. Rev. Code § 21.20.430(7)(1987), generally known as the "Scienter Amendment", which states:

> Notwithstanding subsections (1) through (6) of this section, if an initial offer or sale of securities that are exempt from registration under RCW 21.20.310 is made by this state or its agencies, political subdivisions, municipal or quasi-municipal corporations, or other instrumentality of one or more of the foregoing and is in violation of RCW 21.20.010(2), and any such issuer, member of the governing body, committee member, public officer, director, employee, or agent of such issuer acting on its behalf, or person in control of such issuer, member of the governing body, committee member, public officer, director, employee, or agent of such person acting on its behalf, materially aids in the offer or sale, such person is liable to the purchaser of the security only if the purchaser establishes scienter on the part of the defendant. The word "employee" or the word "agent," as such words are used in this sub-section, do not include a bond

> counsel or an underwriter. Under no circumstances whatsoever shall this subsection be applied to require purchasers to establish scienter on the part of bond counsels or underwriters. The provisions of this subsection are retroactive and apply to any action commenced but not final before July 27, 1985. In addition, the provisions of this subsection apply to any action commenced on or after July 27, 1985.

Wash. Rev. Code. § 21.20.010(2)(1987) provides:

> It is unlawful for any person, in connection with the offer, sale or purchase of any security, directly or indirectly:
>
> * * *
>
> (2) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading.

Thus, the statute at issue here merely clarifies when "scienter" must be proven to recover any damages allegedly arising from a violation of Wash. Rev. Code § 21.20.010(2).

Appellants assert that the Scienter Amendment violates U.S. Const., Art. 1, Section 10, Clause 1, which provides that:

> No State shall . . . pass any Law impairing the Obligation of Contracts . . . .

STATEMENT OF THE CASE

Appellants are plaintiffs in a Washington state court proceeding. They seek to recover losses that allegedly arose due to misrepresentations made in connection with the sale of municipal bonds issued by the Washington Public Power Supply System (the "Supply System"), a municipal corporation organized under the laws of the state of Washington. The Supply System issued the bonds between 1977 and 1981 in the principal amount of $2.25 billion to finance the construction of two nuclear projects for electricity generation in the state of Washington (the "Projects"). These Appellants purchased approximately $40 million of these bonds.

The Bond Resolution, pursuant to which the bonds were issued and sold, provided that debt service obligations on the bonds would be satisfied under the terms of certain "Participants' Agreements." The Participants' Agreements were agreements between the Supply System and 88 public utility entities in the Pacific Northwest (the "Participants"). These agreements provided for the purchase of shares of the generating "capability" of the Projects. If the Projects were completed, the Supply System would pay debt service by selling the Projects' electricity to the Participants. In addition, the Participants' Agreements provided that, if the Projects were not completed, the Participants would nevertheless pay the debt service obligations according to the same share formula under which they had agreed to purchase electricity. Because the Supply System terminated construction of the Projects in January of 1982, when they were still far from complete, this second prong of the Participants' Agreements came into play.

Shortly after the termination of the Projects in January, 1982, Chemical Bank, Trustee for the Projects' bond fund, filed a declaratory judgment action in the Washington state courts seeking a declaration that the Participants' Agreements were valid and enforceable. On June 15, 1983, the Supreme Court of Washington held certain of the Participants' Agreements void *ab initio*. *Chemical Bank v. WPPSS*, 99 Wash. 2d 772, 666 P.2d

329 (1983). This decision hinged on a legal finding that it was an *ultra vires* act for the Washington municipal Participants to enter the Participants' Agreements. On November 6, 1984, the Supreme Court of Washington reaffirmed this *ultra vires* decision, and then held all the other Participants' Agreements unenforceable on the grounds of mutual mistake and commercial frustration. *Chemical Bank v. WPPSS*, 102 Wash. 2d 874, 691 P. 2d 524 (1984), *cert. denied*, 471 U.S. 1065 (1985). As a result of these decisions, no funds were available to the Supply System to make the required payments on the bonds, and a payment default ensued.

Appellants commenced their lawsuit in May of 1984. Prior to that time, several securities fraud class-actions on behalf of Supply System bond purchasers had already been commenced in the federal courts. Numerous federal class-actions have since been consolidated in a multi-district proceeding (the "MDL-551" case), and two classes of bond purchasers have been certified. MDL-551 is set to begin trial on September 7 of this year in Tucson, Arizona, with The Honorable William D. Browning of the District of Arizona presiding. All of the misrepresentation claims in Appellants' lawsuit are in the MDL-551 federal class-action. All of the Appellants are members of at least one of the plaintiff classes in MDL-551.

Appellants' complaint contains twelve (12) alleged causes of action, including a claim against Chemical Bank as bond fund Trustee, several so-called derivative claims, several inventive equity claims, and a claim under Section 12 of the Securities Act of 1933. There is no claim for breach of contract against any defendant. The only claims in the Appellants' complaint that are in issue on this purported appeal arise under the Washington State Securities Act ("WSSA") Wash. Rev. Code § 21.20.010 *et seq.* (1987). This Act permits private lawsuits for violations of certain of its provisions under limited circumstances. A brief review of the relevant provisions of WSSA, and some of the pertinent legislative history, will highlight the issue the Appellants pursue here.

WSSA is a relatively standard collection of statutory provisions governing the purchase, sale or issuance of securities in the state of Washington. Like most such state regulatory schemes, it parallels the federal securities laws to a large extent. Under Wash. Rev. Code §21.20.010, certain types of acts are specifically forbidden in the purchase or sale of securities. Another provision, Wash. Rev. Code §21.20.430, provides for private civil remedies in the event of a violation of Wash. Rev. Code §21.20.010. Appellants brought two claims under Section 21.20.430, one for primary liability under Section 21.20.430(1), and the other charging secondary liability under Section 21.20.430(3).

Prior to 1980, it was commonly understood that recovery in a private action under WSSA required proof of fraud, *i.e.* proof that a violation was committed with intent to defraud, or with scienter. *See, e.g., Ludwig v. Mutual Real Estate Investors*, 18 Wash. App. 33, 567 P.2d 658 (1977). But in *Kittilson v. Ford*, 93 Wash.2d 223, 608 P.2d 264 (1980), the Washington Supreme Court held that under some circumstances scienter need *not* be proven for a violation of Wash. Rev. Code §21.20.010(2), which provides:

> It is unlawful for any person, in connection with the offer, sale or purchase of any security, directly or indirectly:
>
> * * *
>
> (2) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading.

The basic rationale offered in *Kittilson* for not requiring proof of scienter for a violation of this provision appears to have been simply that this provision did not use the words "fraud" or "defraud."

Concerned that public servants could be held liable for simple negligence under this newly announced standard, the Washington legislature promptly enacted a "Scienter Amendment" to WSSA. This amendment insured that a scienter standard would apply to WSSA claims involving the securities of certain Washington public entities. As originally enacted in 1981, the Scienter Amendment provided:

> [I]f an initial offer or sale of securities by the state or its agencies is in violation of RCW §21.20.010(2), each member of the governing body or person in control of the state or agency, each committee member, public officer, or director acting on its behalf, and each employee thereof who materially aids in the offer or sale, are liable to the purchaser of the security only if the purchaser establishes scienter on the part of the defendant.

(Wash. Laws of 1981, ch. 272, § 9(7).) Thus, the new statute mandated that when a security was issued by the state or one of its agencies, a scienter standard would apply to any WSSA claim arising out of that issue and directed at certain persons or entities related to the issuer.

In 1985, the Washington state legislature broadened this scienter requirement. (Wash. Laws of 1985, ch. 171, § 1(7).) This 1985 amendment changed the scienter requirement as follows:

- It broadened the class of public issuers covered by the provision by adding "political subdivisions, municipal or quasi-municipal corporations, or other instrumentality of one or more of the foregoing";

- It added the municipal issuer itself and the "agents" of the issuer to the list of persons to whom the scienter standard applies;

- It restricted the provision to apply only to municipal issues "exempt from registration under

RCW 21.20.310," in keeping with the well-established statutory distinctions related to municipal securities; and

— It expressly excluded bond counsel and underwriters from the scienter standard.

This was where the law stood in October of 1985, when the state trial court dismissed the Appellants' entire complaint on the grounds that none of its twelve counts stated a cognizable cause of action. This dismissal decision of the Washington state trial court then came before the Supreme Court of Washington on direct appeal. In the Washington Supreme Court, Appellants challenged the constitutionality of the Scienter Amendment, and also disputed almost every other aspect of the trial court's dismissal decision. On October 8, 1987, the Supreme Court of Washington reversed the trial court's dismissal decision on a number of grounds, and remanded the case for further proceedings consistent with its opinion. *Haberman v. Washington Public Power Supply System*, 109 Wash.2d 107, 744 P.2d 1032 (1987), *modified and further reconsideration denied*, ____Wash.2d ____, 750 P.2d 254 (1988). In its opinion, the Washington Supreme Court reversed the trial court's dismissal of Appellants' securities claims under Wash. Rev. Code §§ 21.20.430(1) and (3), but denied Appellants' challenge to the constitutionality of the Scienter Amendment as applied to those claims.[2]

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[2] Between the trial court decision and the Washington Supreme Court decision, the Washington legislature amended the Scienter Amendment again, but only to make it clear that it was intended to apply retroactively. (Wash. Laws of 1986, ch. 304, § 7.) The version of the Scienter Amendment reviewed by the Supreme Court of Washington, and thus the version before this Court, is the current law, which contains the retroactive implementation language.

ARGUMENT

I.

THIS COURT LACKS JURISDICTION TO HEAR THIS PURPORTED APPEAL BECAUSE THE ORDER AT ISSUE IS MANIFESTLY NOT FINAL.

Appellants seek to bring this appeal under 28 U.S.C. § 1257(2), which grants jurisdiction to this Court to hear appeals of certain "[f]inal judgments or decrees rendered by the highest court of a State in which a decision could be had." But there is simply no final order or judgment to be found in Appellants' case at this point. Although the decision of the Washington Supreme Court upheld the constitutionality of the Scienter Amendment, that decision clearly permits Appellants to pursue their claims impacted by that Amendment on remand. Appellants thus have a full opportunity in the trial court to litigate the causes of action they seek to have this Court review. Accordingly, this case is not ripe for review by this Court, and this appeal should be dismissed.[3]

A. The Washington Supreme Court's Order Is Not Final On Its Face.

The Washington Supreme Court remanded Appellants' WSSA claims for trial, and thus clearly did not render a decision that "ends the litigation on the merits and leaves nothing for the court to do but execute the judgment." *Stringfellow v. Concerned Neighbors in Action*, __ U.S. __, 107 S. Ct. 1177, 1181 (1987) (*quoting Catlin v. United States*, 324 U.S. 229, 233 (1945)). Appellants do not dispute this point, and, in fact, concede that they could well "prevail at trial on non-federal grounds." (Haberman Jurisdictional Statement, p. 3.) Thus, even Appellants

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[3] Dismissal of this appeal and the companion appeal of the Intervenors would mandate dismissal of the cross-appeal of defendant Wood Dawson Smith & Hellman, since they have asserted no basis for this Court's jurisdiction over their cross-appeal other than the existence of the primary appeals. (*See* Wood Dawson Jurisdictional Statement on Cross-Appeal, pp. 6-7.)

accept that the Washington Supreme Court's decision is not a "final judgment or decree" in the traditional sense.

In spite of this concession, or because of it, Appellants nevertheless seek to invoke this Court's appellate jurisdiction, arguing that the order of the Supreme Court of Washington, although not "final," falls under the doctrine of *Cox Broadcasting Corp. v. Cohn*, 420 U.S. 469 (1975). But Appellants misread *Cox*. The doctrine of that case is not some elastic contrivance that can reshape itself to match whatever exigencies a frustrated appellant confronts. Rather, *Cox* demands that any prospective appeal fit a set of specific criteria. Appellants are simply unable to fit the facts of this case within the *Cox* standards.

B. The *Cox Broadcasting* Doctrine Does Not Apply To This Order.

In *Cox Broadcasting*, this Court recognized four narrow exceptions to the requirement of strict finality. 420 U.S. at 476-87. Appellants urge this Court to find jurisdiction within the second and the fourth exceptions identified in *Cox Broadcasting*. However, the facts of this action do not fit either of those *Cox* exceptions.*

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* In *Cox*, this Court enumerated the following four situations where it would review a non-final order of a state's highest court deciding a federal issue:

1. Where further proceedings have yet to occur, but the federal issue (as decided by the state's highest court) preordains the outcome of those proceedings, making the case "final" for all practical purposes. 420 U.S. at 479 ("the first *Cox* exception").

2. Where the federal issue will necessarily survive and require review, regardless of the eventual outcome of the state proceedings. *Id.* at 480 ("the second *Cox* exception").

3. Where the federal question could never again be reviewed by this Court, no matter what the outcome of the state proceedings. *Id.* at 481 ("the third Cox exception").

4. Where: (a) reversal by this Court on the federal issue would be preclusive of any further litigation; and (b) the state court decision might seriously erode federal policy. *Id.* at 482-83 ("the fourth *Cox* exception").

1. *The Present Case Does Not Fall Within The Second* Cox Broadcasting *Exception Because The Federal Issue Will Not Necessarily Survive After Further State Proceedings.*

Appellants first assert that this case falls into the second *Cox* exception to strict finality, arguing that there is a "federal constitutional issue [that] has been finally decided by the highest court in the state of Washington [and] which 'will survive and require decision regardless of the outcome of further state court proceedings.' " (Haberman Jurisdictional Statement, p. 3, *quoting Cox*, 420 U.S. at 480.) This statement is incorrect. Appellants would have no basis to challenge the Scienter Amendment if they were to prevail at trial using the higher standard of proof required by that legislation. Because further state court proceedings could yet render review of Appellants' constitutional claim unnecessary, the second *Cox* exception to finality does not apply to this case.

It is also noteworthy that this Court defined the second *Cox* exception with reference to cases where a defendant needs protection from immediate harm.[5] This factor further distinguishes

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[5] The cases cited by this Court in *Cox Broadcasting* in support of the second category all arguably involve elements of immediate hardship. Wright, Miller, Cooper & Gressman, *Federal Practice and Procedure: Jurisdiction* § 4010. Commentators suggest that this category makes more sense with such a requirement. *Id.* For example, in *Radio Station WOW, Inc. v. Johnson*, 326 U.S. 120 (1945) and in *Carondelet Canal & Nav. Co. v. State of Louisiana*, 233 U.S. 362 (1914), both state high courts ordered property to be delivered to the opposing party immediately. The loss of control by the litigants of their property could have caused immediate harm and, consequently, this Court's review ensured expedited analysis of that hardship. In *Brady v. State of Maryland*, 373 U.S. 83 (1963), this Court allowed the review of a state court judgment forcing a criminal defendant to undergo a retrial on the question of punishment, but not on the question of guilt. This Court determined that the federal issue was separable and would not be mooted by the trial, and determined that an immediate review should occur before the defendant suffered the burden of a potentially improper trial.

the present case, where Appellants, who are plaintiffs, are not being forced to give up control of any property or endure a trial that might endanger their civil liberties. Indeed, Appellants demonstrate no special hardship indicating that expedited review would be appropriate in this case.

Having conceded that the federal issue will not necessarily survive further state court proceedings, and having failed to show any particular harm that will follow upon remand, Appellants have manifestly not met the second *Cox* exception as a basis for this Court's jurisdiction.

2. *The Present Case Does Not Fall Within The Fourth* Cox Broadcasting *Exception Because Reversal On The Federal Question Will Not Be Preclusive Of Further Litigation, And Because The Order In Issue Involves No Erosion Of Federal Policy.*

Appellants also base their jurisdictional statement on the fourth *Cox* exception. To fit under the fourth exception, Appellants have to show *both* (1) that "reversal of the state court on the federal issue would be preclusive of any further litigation on the relevant cause of action," *and* (2) that "a refusal immediately to review the state court decision might seriously erode federal policy." 420 U.S. at 482-83. Again, Appellants' reliance on this exception is misplaced.

a. Reversal By This Court Will Not Terminate Litigation Of Appellants' WSSA Claims.

Appellants stretch their view of this case too far when they suggest that a reversal by this Court of the state court decision "will likely result in summary disposition of this case." (Haberman Jurisdictional Statement, p. 4.) This statement is unsupported and unsupportable. Even were a negligence standard to apply to their WSSA claims, Appellants would still have to prove that some defendant made an "untrue statement" of a material fact in connection with the sale of Supply System bonds,

and did so negligently. Appellants apparently believe that inaccurate forecasts, such as those arguably at issue in this case (*see* Haberman Jurisdictional Statement, p. 8), constitute *per se* "untrue statements" for purposes of a WSSA claim. But a failure to predict the future does not constitute an untruth, and no Washington court, or any other court, has ever endorsed the "fraud by hindsight" approach assumed by the Appellants. In short, Appellants have a long way to go to prove that anyone made an "untrue" statement of material fact in this case.

Hence, reversal by this Court would only change the standard of culpability required to be shown at trial from a scienter standard to a negligence standard. Therefore, reversal would "merely control the nature and character of . . . the state proceedings still to come." *Cox Broadcasting*, 420 U.S. at 483. Such a reversal would not "be preclusive of any further litigation on the relevant cause of action," as is required by the first part of the fourth *Cox* exception. *Cox Broadcasting*, 420 U.S. at 482-83; *accord Southland Corp. v. Keating*, 465 U.S. 1, 6-7 (1984). Because a reversal would not preclude further action, an exception to the finality requirement is not warranted.[6]

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[6] Because reversal would not determine the outcome of Appellants' WSSA claims, this case is not like the three "fourth exception" cases that Appellants cite. For instance, in *Southland Corp. v. Keating*, 465 U.S. 1 (1984), this Court allowed the appeal in part because "reversal of a state-court judgment in this setting will terminate litigation of the merits of this dispute." In *Hudson Distributors, Inc. v. Eli Lilly & Co.*, 377 U.S. 386 (1964), a retailer brought suit to invalidate a state fair trade act on federal antitrust grounds and lost. This Court accepted review, noting that the issues still pending in the Ohio courts were separate from the validity of the statute. *Id.* at 389 n.4. If this Court had reversed the Ohio Supreme Court and invalidated the statute, the remanded state court proceedings to enforce the statute would have been terminated. Finally, in *Mercantile National Bank v. Langdeau*, 371 U.S. 555 (1963), two defendant national banks asserted that a special federal venue statute immunized them from suit in Texas. The Texas Supreme Court refused to enforce the federal venue statute and remanded for trial. This Court accepted review, stating that the venue issue was "a separate and independent matter, anterior to the merits and not enmeshed in the factual and legal issues comprising the plaintiff's cause of action." *Id.* at 558. This Court then upheld the venue statute and reversed the Texas decision, thereby terminating the suit against the national banks in the improper venue.

b. Refusing Immediate Review Will Not Erode Federal Policy.

Appellants likewise fail to satisfy the second element of the fourth *Cox* exception. In no way do they show that a serious erosion of federal policy will result if the Washington Supreme Court decision is allowed to stand pending trial. *Cox*, 420 U.S. at 483. Their attempt to satisfy this element — by claiming that an important federal policy is at stake in "allowing a state legislature without good cause to alter retroactively contract remedies" (Haberman Jurisdictional Statement, p. 3) — would be more compelling if it had something to do with this case.[7] There is simply no responsible basis for arguing that the Washington state legislature passed any law affecting contract remedies. Rather, the statute at issue amended the standard of proof for a *statutory* remedy. *See*, pp. 16-20, *infra*.

In any event, the standard of proof to be applied to Appellants' state securities law claims does not conflict with any federal policies. This is certainly not a case where First Amendment rights will be chilled if the state decision is left unreviewed. *Cf. Cox*, 420 U.S. at 485-86. Nor is this a case where a federal statutory scheme will be undermined if an incorrect state court decision is left standing. *Cf. Southland Corp.*, 465 U.S. at 6-7 (Federal Arbitration Act); *Hudson Distributors*, 377 U.S. at 395 (Sherman Act); *Mercantile National Bank*, 371 U.S. at 558-62 (National Banking Act). To the contrary, the Washington Supreme Court decision requires Appellants to try their state law securities claims under a scienter standard of proof *consistent* with the federal securities law scheme. *See Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193, *rehearing denied*, 425 U.S. 986 (1976) (scienter is an essential element of a federal securities law fraud claim under § 10(b) of the Securities Exchange Act of 1934).

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[7] As was recently called to this Court's attention (*see* letter from David G. Keyko to Joseph F. Stanoil, Jr., Clerk of the Court, dated June 23, 1988), the United States District Court in MDL-551 has upheld the Scienter Amendment notwithstanding challenges based on federal policy and constitutional grounds.

The resolution of Appellants' constitutional claims "can await final judgment without any adverse effect upon important federal interests. A contrary conclusion would permit the fourth [*Cox*] exception to swallow the rule." *Flynt v. Ohio*, 451 U.S. 619, 622 (1981). Since no federal policy will be undermined by allowing this case to go to trial without a review by this Court of the culpability standard, this appeal should be dismissed.

II.

THE APPELLANTS' CONVOLUTED "IMPAIRMENT OF CONTRACTS" ARGUMENT PRESENTS NO SUBSTANTIAL FEDERAL QUESTION.

The most obvious problem with Appellants' "impairment of contracts" argument is that it is not an "impairment of contracts" argument at all. Indeed, in their complaint, Appellants do not even seek to recover for a contract breach. Rather, they seek to recover on a statutory remedy, and their objection on this appeal is to the stricter burden of proof created for that statutory remedy by the Scienter Amendment. Appellants' objection, therefore, is to a change in a statutory remedy, and not to an impairment of a contract.

Generally, a mere change in remedy does not infringe upon the right to contract or infringe upon the right to enforce a contract, and thus raises no issue under the Contracts Clause. *Home Bldg. & Loan Assoc. v. Blaisdell*, 290 U.S. 398, 430 (1934); *Karl v. Bryant Air Conditioning Co.*, 705 F.2d 164, 166 (6th Cir. 1983) (no violation of Contracts Clause because "legislative modification of remedy does not infringe the plaintiff's right to contract or deprive him of his contract enforcement cause of action"). Where, as here, Appellants complain of a change in a remedy to a *statutory* cause of action, they are even further from a violation of the Contracts Clause.

A. No Contractual Obligation Is Impaired By The Scienter Amendment.

To support a claim that a statute violates the Contracts Clause of the Constitution, Appellants must first show that the state law has operated as a substantial impairment of a contractual obligation. *Energy Reserves Group, Inc. v. Kansas Power & Light*, 459 U.S. 400, 411 (1983), *citing Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 244-245, *rehearing denied*, 439 U.S. 886 (1978). A law impairs contractual obligations when it "renders them invalid, or releases or extinguishes them." *Home Bldg. & Loan Assoc. v. Blaisdell*, 290 U.S. 398, 431 (1934), *citing*

Sturges v. Crowninshield, 17 U.S. (4 Wheat.) 122, 197, 198 (1819). The Scienter Amendment, however, does not create, release or extinguish any contractual obligations. Indeed, this piece of legislation does not affect the contractual obligations of any known person.

Appellants' entire "contracts" argument rests on a single provision in the Bond Resolution for the Supply System bonds. This provision reads as follows:

> This Resolution is adopted under the authority of and in full compliance with the Constitution and laws of the State of Washington, including Titles 43 and 54 of the Revised Code of Washington, *as amended and supplemented*. In consideration of the purchase and acceptance of the Bonds by those who shall hold the same from time to time, the provisions of the Resolution and of said laws shall constitute a contract with the holder or holders of each Bond and coupon pertaining thereto, and the obligations of the System and the Board under said laws and under the Resolution shall be enforceable by any court of competent jurisdiction, and the covenants and agreements herein set forth to be performed on behalf of the System shall be for the equal benefit, protection and security of the holders of any and all of said Bonds and coupons pertaining thereto, all of which regardless of the time or times of their issue or maturity shall be of equal rank without preference, priority or distinction of any of said Bonds or coupons pertaining thereto over any others thereof except as expressly provided in the Resolution. (Emphasis added.)

On its face, this provision merely implements the Resolution itself, informing prospective bondholders that the Supply System has authority to adopt the Resolution, and that it undertakes to honor its terms, and obey the laws of the State of Washington "as amended and supplemented."

Given the language at issue, it is hard to fathom the Appellants' construction of this provision. They appear to argue

that this provision stopped legal time in its tracks, or that it caused the sovereignty of the State of Washington to be surrendered surreptitiously to the Supply System bondholders. Whatever the argument, Appellants clearly contend that this passage of the Bond Resolution prohibited the Washington legislature from changing the state's framework for securities regulation, or for that matter, presumably from changing any other statutory provision affecting the Supply System. (Haberman Jurisdictional Statement, pp. 16-17.)

Efforts by litigants to use the Contracts Clause in this fashion have long been rejected. The Contracts Clause does not destroy the power of the states to regulate matters of public interest. As this Court has observed, the Contracts Clause cannot have the reach that Appellants seek for it because:

> [o]therwise, one would be able to obtain immunity from state regulation by making private contractual arrangements. This principle is summarized in Mr. Justice Holmes' well-known dictum: "One whose rights, such as they are, are subject to state restriction, cannot remove them from the power of the State by making a contract about them." *Hudson Water Co. v. McCarter*, 209 U.S. 349, 357 (1908).

United States Trust Co. v. New Jersey, 431 U.S. 1, 22 (1977). Even if the Appellants' reading of the Bond Resolution did not fly in the face of traditional understandings of the Contracts Clause, the fact of the matter is that the Bond Resolution envisions and adopts state law "as amended and supplemented." In short, the Bond Resolution contemplates amendments to state law, and even if it did not, the Contracts Clause does not permit private parties to leash the legislature of a state, as Appellants contend.

Finally, Appellants need a contract claim to have a Contracts Clause argument. To put it bluntly, either the Supply System breached a contractual promise under the above provision or it did not. If it did, the Appellants can sue for breach of contract,

without regard to the standard of recovery under WSSA. Whether they can also sue for a WSSA claim, and what they must prove to prevail on that claim, is a different issue. The Scienter Amendment deals with this second issue, not the breach of contract question. Without a claim that a contractual obligation has been impaired, the Appellants have no constitutional issue under the Contracts Clause.[8]

Appellants allude to several recent cases decided by this Court that have found constitutional impairments of contracts, but these cases are not even remotely on point. In *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234 (1978), for example, the Minnesota legislature had passed a law requiring certain corporations to fund a pension for the benefit of any employee having over 10 years of service whenever a factory in Minnesota was closed. The Allied Structural Steel Company had a pension plan that required, among other things, at least 15 years of service for vesting of pension benefits. Nine company employees, each with over 10 years of service, were released without pension benefits when the company closed a plant. During this Court's examination of the contractual obligations, the Court determined that the Minnesota statute altered the contractual relationship. The obligations imposed by the law directly added to those required in the pension plan contract. 438 U.S. at 240. This Court observed that the law abrogated express terms of the contract, thereby changing the corporation's contractual obligations for funding pensions. *Id.* at 247. Moreover, the statute affected an

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[8] Appellants undoubtedly have not sued for breach of contract because the Bond Resolution expressly limits any monetary recovery for a breach of contract to the funds in the Projects' bond fund. Pursuant to the Bond Resolution, the Supply System has already turned over the entire bond fund (an amount exceeding $100 million) to the bond fund Trustee, Chemical Bank. The Supply System thus has no funds to pay on a breach of contract claim. Moreover, a claim on the contract can only be directed at the Supply System, not the host of other defendants Appellants have sued. In short, there is a remedy limitation for breach of contract in the Bond Resolution itself, and the Appellants know well that victory on a breach of contract claim would be fruitless. Of course, the Scienter Amendment has nothing to do with any limits on the breach of contract remedy.

area not previously subject to governmental regulation. For those reasons, the Minnesota statute violated the Contracts Clause. The Scienter Amendment at issue here, however, does not change or affect any term of the Bond Resolution in any way, and consequently, *Allied Structural Steel* is totally inapposite.

United States Trust Co. v. New Jersey, 431 U.S. 1 (1977), another case cited by Appellants, also is inapposite. In *United States Trust Co.*, New Jersey and New York repealed a statutory covenant between themselves and "with the holders of any affected bonds" that *specifically stated* that the New York-New Jersey Port Authority could not use certain funds pledged as security for the affected bonds in any manner other than those enumerated in the covenant. There never was any question that the repealed statute specifically contemplated a covenant among the two states and the bondholders. In holding the statutes repealing the covenant unconstitutional, this Court determined that the covenant created a contractual obligation for the two states, that "the purpose of the covenant was to invoke the constitutional protection of the Contract Clause as security against repeal," and that "[i]ts outright repeal totally eliminated an important security provision and thus impaired the obligation of the States' contract." *United States Trust Co.*, 431 U.S. at 18-19. The Scienter Amendment to the Washington State Securities Act has no such effect upon the obligations of the parties to the Bond Resolution. No party to the contract is required by the Scienter Amendment to do any more or less than promised; nor do any of the obligations imposed by the Bond Resolution vanish because of the Scienter Amendment.

B. The Scienter Amendment Is A Legitimate Exercise Of The State Of Washington's Police Power.

This Court has long held that, even if a statute impairs some contractual obligation, that statute is not automatically unconstitutional:

> It is the settled law of this court that the interdiction of statutes impairing the obligation of contracts does

> not prevent the State from exercising such powers as are vested in it for the promotion of the common weal, or are necessary for the general good of the public, though contracts previously entered into between individuals may thereby be affected. This power, which in its various ramifications is known as the police power, is an exercise of the sovereign right of the Government to protect the lives, health, morals, comfort and general welfare of the people, and is paramount to any rights under contracts between individuals.

Manigault v. Springs, 199 U.S. 473, 480 (1905). Of course, this power does not go unchecked, and, if "the state regulation constitutes a substantial impairment, the State, in justification, must have a significant and legitimate purpose behind the regulation." *Energy Reserves Group*, 459 U.S. at 411, *citing United States Trust Co.*, 431 U.S. at 22.

While there is no impairment in this case, let alone a substantial impairment, the significant and legitimate public policy test could certainly be passed here. The specific public policy justifications for the Scienter Amendment are treated more fully in the companion brief on the motion to dismiss or affirm directed at the appeal of the Intervenors in this case. Here, we note only one specific respect in which the Scienter Amendment clearly passes the traditional tests of constitutional scrutiny. This Court, in *Allied Structural Steel*, listed the attributes of statutes that have survived a challenge based on the Contracts Clause, even when a contractual obligation had been impaired. 438 U.S. at 250. This list included statutes that regulate an area already subject to state regulation at the time the contractual obligations were originally undertaken. *Id.*, *citing Veix v. Sixth Ward Bldg. & Loan Assn.*, 310 U.S. 32, 38 (1940). In the present case, the Scienter Amendment affected only Washington's securities laws, an area already subject to extensive state regulation when the Supply System Bond Resolution took effect. Because Washington continued to regulate this area, the Scienter Amendment fits squarely within an approved category of statutes that

this Court has consistently sustained against Contracts Clause challenges.

Moreover, unlike New York and New Jersey in *United States Trust Co.*, the state of Washington made no promise restricting its ability to change WSSA. Absent such a promise, no surrender of the state's right to regulate as it sees fit can be presumed. This Court has held that plaintiffs' reasonable expectations under contracts drawn subject to extensive regulation are not impaired by subsequent state actions within the regulated area. *Energy Reserves Group*, 459 U.S. at 417. As this Court put this principle:

> To enact laws providing remedies for a violation of contracts [to say nothing of laws providing remedies for violation of statutes], to alter or enlarge those remedies from time to time as to the legislature may seem appropriate, is an exercise of sovereignty, and it cannot be supposed that the State in a case like this, contracts in a public act of its legislature, to limit its power in the future, even if it could do so, with or without consideration, unless the language of the act is so absolutely plain and unambiguous as to leave no room for doubt that its true meaning amounts to a contract by it to part with its power to increase the effectiveness of existing remedies as against those who purchase lands while the act remains alive. No such language is to be found in the act in question, and none ought to be implied.

Waggoner v. Flack, 188 U.S. 595, 603 (1903). In this case, the act in question does not limit Washington's power to amend and supplement its laws. Thus, no contractual promise can be inferred that could possibly limit Washington's ability to change the statutory remedy.

CONCLUSION

For the reasons stated above, this Court should dismiss this appeal or, in the alternative, affirm the decision of the Washington Supreme Court.

Respectfully submitted,

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STATEMENT PURSUANT TO RULE 28.1

The parent of appellee PaineWebber Incorporated is Paine Webber Group, Inc. Appellees Blyth Eastman Paine Webber Incorporated and Paine Webber Jackson & Curtis, Inc. have been subsumed in the corporate entity, PaineWebber Incorporated, and no longer exist and operate as separate corporate entities. There are no PaineWebber Incorporated subsidiaries or affiliates except wholly-owned subsidiaries.

The parent of appellee Ebasco Services Incorporated is Enserch Corp. Ebasco Services Incorporated has the following subsidiaries: E&L Associates Inc.; E&L Technologies Inc.; Ebasco Constructors Inc.; Ebasco Corporation; Ebasco Energy Resources, Inc.; Ebasco Engineering and Construction Corporation; Ebasco Industries Inc. (Delaware); Ebasco International Corporation; Ebasco Overseas Corporation; Ebasco Plant Services Inc.; Ebasco Risk Management Consultants, Inc.; Ebasco Services International Inc.; and Gates Engineering Consultants.

Appellee R.W. Beck and Associates is a partnership with no corporate parents, affiliates or subsidiaries, except wholly-owned subsidiaries.

The remaining appellees joining in this motion are either municipalities or municipal corporations. They have no corporate parents, affiliates or subsidiaries.